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APPENDIX A — OPINIONS BELOW

COURT OF APPEALS OF THE STATE OF MICHIGAN

L. A. DAVIDSON,
Plaintiff-Appellee,
v.
THE DIVISION OF REVENUE OF THE DEPARTMENT OF TREASURY, STATE OF MICHIGAN,
Defendant-Appellant.

No. 2522

ORDER

AT A SESSION OF THE COURT OF APPEALS OF THE STATE OF MICHIGAN, Held at the Court of Appeals in the City of Lansing, on the 18th day of September in the year of our Lord one thousand nine hundred and sixty-seven.

Present the Honorable

T. John Lesinski
Presiding Judge

Thomas Giles Kavanagh
Louis D. McGregor
Judges

In this cause a motion for a peremptory order, in accordance with GCR 1963, 820.1(7), reversing the judgment of the Ingham County Circuit Court, is filed, and a brief in opposition thereto having been filed, and due consideration thereof having been had by the Court,

IT IS ORDERED that the motion for a peremptory order be, and the same is hereby GRANTED, for the reason that the contrary holding on the same issue by the Supreme Court in *Walter Toebe & Co. v. Revenue Department* (1967), 378 Mich 617, is dispositive of the matter.

The case is remanded to the Ingham County Circuit Court with instructions to render a determination of the other issues involved.

IT IS FURTHER ORDERED that the motion to affirm be, and the same is hereby DENIED.

STATE OF MICHIGAN—ss.

I, Ronald L. Dzierbicki, Clerk of the Court of Appeals of the State of Michigan, do hereby certify that the foregoing is a true and correct copy of an order entered in said court in said cause; that I have compared the same with the original, and that it is a true transcript therefrom, and the whole of said original order.

IN TESTIMONY WHEREOF, I have hereunto set my hand and affixed the seal of said Court of Appeals at Lansing, this 21st day of September in the year of our Lord one thousand nine hundred and sixty-seven.

(s) Ronald L. Dzierbicki
Clerk

STATE OF MICHIGAN

IN THE CIRCUIT COURT FOR THE COUNTY OF INGHAM

L. A. DAVIDSON,
Plaintiff,

v.

Docket No. 45136

MICHIGAN DEPARTMENT OF REVENUE,
Defendant.

DECLARATORY JUDGMENT

The above entitled action was first brought at issue before the Court by a motion on the part of the defendant, Michigan Department of Revenue, to dismiss the plaintiff's bill, which motion was denied in a finding of the Court dated December 3, 1962, and the Court, in its opinion, announced its findings of law controlling the issues presented.

Thereafter, by stipulation of the parties filed in said cause, the period over which taxes were alleged to have accumulated was extended from the original date of September 30, 1961 to and including August 27, 1964, which was the full period during which Act No. 272 of Public Acts of 1959, the constitutionality of which was an issue in this cause, remained in the Statutes of the State of Michigan.

By its finding of December 3, 1962, the Court determined that Act 272 of Public Acts of 1959 was unconstitutional.

By stipulation on file in said cause, it was agreed between the parties that if the finding of the Court, as recited, holding Act 272 of the Public Acts of 1959 unconstitutional were to stand as final, "all liability of the plaintiff for sales or use taxes and interest to and including August 27, 1964 are fully paid".

The parties having eliminated, by agreement, all questions except that of the constitutionality of Act 272 of

Public Acts of 1959, the Court concludes that the declaratory relief claimed by the plaintiff in his original bill of complaint and over the period extended by stipulation of the parties, should be granted;

IT IS THEREFORE HEREBY ORDERED and ADJUDGED that Act 272 of the Public Acts of 1959 is unconstitutional and that any assessment issued by the defendant, Michigan Department of Revenue, against the plaintiff, L. A. Davidson, in reliance upon the provisions of said Act 272 of Public Acts of 1959 are void and of no effect and that the obligation of the plaintiff for sales and use taxes to and including August 27, 1964, with any interest thereon, are fully paid.

(s) Marvin J. Salmon
Circuit Judge

Dated at Lansing, Michigan
This 18 day of July, 1966.

Approved as to form:

(s) Maurice Barbour
(s) Carl H. Reynolds

STATE OF MICHIGAN
IN THE CIRCUIT COURT FOR THE COUNTY OF INGHAM, IN CHANCERY

L. A. DAVIDSON,
Plaintiff,

v. Docket No. 45136

MICHIGAN DEPARTMENT OF REVENUE,
Defendant.

OPINION OF THE COURT

Plaintiff has filed a bill for declaratory judgment in which he asks this Court to determine and find that he is not liable for certain taxes assessed against him by the defendant under Act 94 of the Public Acts of 1929 as amended (Stat. Ann. 7.555 (1) et seq), this being the "Use Tax Act", on certain equipment and materials used by him in constructing highways under contracts with the Michigan State Highway Department.

More specifically he prays that this Court decree as follows:

"(A) That he is not a 'consumer' within the meaning of that term as defined in Sec. 2 (g) of Act 94, Public Acts of 1937, as amended.

(B) That the unappealed from decision of this Court in the case of *L. A. Davidson v. Michigan Department of Revenue,* Ingham County Circuit Court, in Chancery No. 36,545, is binding upon the defendant and that defendant's assessments against plaintiff for the period 1955 through December 31, 1959 are unlawful, null and void and that plaintiff is not obliged or required to comply with said assessments or pay the taxes specified therein for said period.

(C) That the amendments purportedly made to the Use Tax Act by Act 235, Public Acts of 1955 and Acts 263 and 272, Public Acts of 1959 were not validly enacted.

(D) That Act No. 94, Public Acts of Michigan, 1937, as amended by Act No. 272, Public Acts of Michigan, 1959, is unconstitutional, null and void insofar as it purports to require Plaintiff to pay a Use Tax with respect to property purchased by him in fulfillment of contracts with the State of Michigan, its departments or institutions; that the Use Tax assessment heretofore made against plaintiff by defendant for the period January 1, 1960 through September 30, 1961, is unlawful, null and void, and that plaintiff is not obliged or required to comply with said assessment or pay the tax specified therein.

(F) That the Court unequivocally defines the exemptions applicable under the provisions of Act 167 of the Public Acts of Michigan of 1933, as amended at the date hereof, and Act 94 of the Public Acts of Michigan of 1937, as amended at the date hereof with respect to plaintiff's purchases for the period October 1, 1961 to date, and to all purchases of like nature which he may make in the future."

The defendant has filed a motion to dismiss the bill for the following reasons:

"1. That no case or controversy exists between the plaintiff and the Michigan Department of Revenue and that any controversy over the intent to assess F 65377 of June 4, 1962 (attached hereto as Exhibit A), and the letter of assessment in regard to the intent to assess F 65377 (attached hereto as Exhibit B), is not now subject to judicial review.

2. That the substantive questions sought to be raised in the so-called 'Bill for Declaratory Judgment' have been conclusively adjudicated in the case of:

L. A. Davidson, Plaintiff v. James M. Hare, Secretary of State of the State of Michigan, Defendant, Mich-

igan Supreme Court Calendar No. 48,800, decided 12/1/61 (365 Mich 162), rehearing denied 3/15/62.

3. That the Plaintiff has not set forth a case or controversy in his so-called 'Bill for Declaratory Judgment' under the provisions of Act No. 36, Public Acts of 1929, as amended (MSA 27.501, et seq).

4. That, in any event, the so-called "Bill for Declaratory Judgment" does not set forth a cause of action."

The parties have filed briefs and oral argument was heard on November 15, 1962. The argument went to the issues of res judicata and the constitutionality of the 1959 amendment, (Act 272 Public Acts 1959) and the Court was informed at that time that these two issues were the only issues which the parties were requesting be determined under the motion.

As to the issue of res judicata the plaintiff contends that the unappealed from decision of February 14, 1957 of the Ingham County Circuit Court in the case of Davidson vs. Department of Revenue, Chancery Docket No. 26,545 is res judicata as to purchases by plaintiff of equipment prior to January 1, 1960, this being the effective date of Act 272, Public Acts 1959.

On the other hand the defendant contends that the case of L. A. Davidson v. James M. Hare, Secretary of State, 365 Mich 162, decided December 1, 1961 conclusively adjudicated the questions sought to be raised in plaintiff's bill.

To decide this issue it is necessary to consider the Use Tax Act in light of some of the changes made therein from time to time and cases decided thereunder.

The act as amended by Act 273 of Public Acts of 1949 provided in Section 4 (m) and (i) that the tax should not apply to property purchased by persons engaged in the business of constructing, altering or improving real es-

tate for others when property so purchased by such persons was affixed to and made a structural part of real estate in the fulfillment of a contract with the United States, the State of Michigan or any of its political subdivisions.

Then on December 29, 1953 our Supreme Court in the case of Garavaglia vs. the Department of Revenue 338 Mich 467 decided that materials such as form lumber, nails, etc. used in the performance of contracts for construction jobs with the State Highway Department were not subject to Use Tax even though the materials sought to be taxed did not become a part of the highway. The Court said:

> "It clearly appears from the language of Sec. 4 of the General Sales Tax Act that the Legislature intended that the Department of Revenue could not impose a direct or indirect sales or use tax upon another entity of the State of Michigan."
>
> (Stat. Ann. 7.524)

In light of the Garavaglia case the Legislature by Act 235 of Public Acts 1955 effective October 14, 1955 amended Sec. 4 (m) of the Use Tax Act (Stat. Ann. 7.555 (4) (m) (i)) to read as follows:

> "Sec. 4. The tax hereby levied shall not apply to: * * * (m). Property purchased by persons engaged in the business of constructing, altering, repairing, or improving real estate for others when property so purchased by such persons shall be affixed and made a structural part of real estate *or used and completely consumed in the fulfillment of a single contract within the exempt classifications set forth in sub-sections (b), (i), (j), and (k) of this section;*" * * * (Emphasis ours)

It is clear that following the above amendment in 1955 the use tax applied to Plaintiff on equipment purchased by him and not completely consumed in the fulfillment of

a single contract unless as claimed by him the 1957 unappealed from decision of the Ingham County Court is res judicata of the matter.

The decision last above mentioned concerned equipment purchased by the plaintiff on February 28, 1953 and October 29, 1954 and the Defendants' assessment of October 10, 1955. The purchases and assessment being made before the 1955 amendment, the Ingham County Court applied the rule laid down in Garavaglia supra and not the amendment, and held that the plaintiff was not required to pay a tax thereon.

The Decree entered by this Court on February 14, 1957 in the above mentioned case provides in part as follows:

> "The Court finds that the transaction upon which a tax has been assessed by the Defendant under color of authority of Public Act 167 of the Public Acts of Michigan of 1933, as amended, (the so-called Sales Tax Law), and which authority is questioned in this case, are exempt from such tax under the holding of the Supreme Court of Michigan in the case of *Garavaglia v. Michigan Department of Revenue*, 338 *Mich* 467, because imposition of the tax would impose the burden thereof upon an agency of the State, its Highway Department; from which all state agencies are exempt, under the law. On motion of Carl H. Reynolds, attorney for the Plaintiff, It is ordered, Adjudged and Decreed that the assessments herein complained of are void and of no effect."

Plaintiff still contends that the above-mentioned Decree was decided in light of the 1955 amendment and is res judicata as to purchases thereafter. This Court does not so find and the case was not so treated by our Supreme Court, when on December 1, 1961, it decided Davidson vs. Secretary of State, 365 Mich 162.

That case clearly does not treat the unappealed from decision as res judicata and departs from the Garavaglia

case and is to the effect that under the 1955 amendment when the Legislature said "completely consumed in the fulfillment of a single contract" that plaintiff was not entitled to purchase free of the tax equipment not so consumed in fulfillment of a single contract.

That case in our opinion even though the matter of res judicata was not expressly dealt with by the Court is nonetheless res judicata of the fact that purchases of equipment and other materials, after adoption of the 1955 amendment, were taxable as provided therein. The argument has been advanced by Plaintiff that because the Department of Revenue was not a party to said suit that it cannot now claim res judicata by virtue of it. "Ordinarily there is privity between officers or agencies of the same government" (50 CJS Pg. 335), and that rule appears to be applicable here.

As to the constitutionality of Act 272 Public Acts 1959 that issue arises by virtue of the fact that prior to September 1, 1959 Sec 4 (m) and (i) of the act exempted property purchased in fulfillment of contracts with the United States, the State of Michigan and its political subdivisions. In 1959, Sec. 4 (m) was amended by Act 263, Public Acts 1959, effective September 1, 1959, thereby eliminating the United States as an exempt entity and was again amended in 1959 by Act 272 Public Acts 1959, effective January 1, 1960 thereby eliminating the State of Michigan as an exempt entity leaving among others the political subdivisions of our State as exempt entities.

Plaintiff claims that road contractors transacting business with governmental entities constitute a single class of taxpayers and that the legislature cannot constitutionally tax said contractors with the State while exempting contractors with its political subdivisions. More specifically in this regard plaintiff avers as to the last amendment that:

> "(a) it discriminates against plaintiff as a contractor with the Michigan State Highway Department, a De-

partment of the State of Michigan, and constitutes unreasonable and arbitrary class legislation and deprives Plaintiff of his property without due process of law and denies to Plaintiff the equal protection of the laws, contrary to the Fourteenth Amendment to the Constitution of the United States;

(b) it constitutes unreasonable and arbitrary class legislation and deprives Plaintiff of his property without due process of law, contrary to Article II, Section 16 of the Constitution of the State of Michigan;

(c) it contravenes Article X, Section 4 of the Constitution of the State of Michigan for the reason that said tax is not uniform upon the classes upon which it operates;

(d) it constitutes a clear and hostile discrimination against contractors with the Michigan State Highway Department with the objective of imposing the economic burden of a tax on the funds contributed by the United States under the Federal Highway Act adopted on August 27, 1958 (72 Stat. 885; Title 23, U.S. Code, Section 101, etc.) and violates the constitutional immunity of the United States from state taxation."

On the other hand the defendant contends that the Legislature has the power to classify those doing business with political subdivisions differently for taxation purposes than those doing business with the State of Michigan; and further contends that the Plaintiff has the burden of establishing that the classification here invoked cannot be justified under any set of circumstances. In that regard the Plaintiff says that on the basis of the facts pleaded in his bill and statutes and cases cited in his brief he has shown that there are no known circumstances justifying the new classification attempted to be made by Act 272, Public Acts 1959, with respect to road contractors doing business with governmental entities, and that the burden of going forward is now on the Defendant. The Defendant

has not pointed out in any way any facts or circumstances justifying the imposition of the tax on contractors with the State and exempting contractors with the political subdivisions thereof.

The Court is approaching this matter on the basis that "All reasonable presumptions and intendments are in favor of the reasonableness and fairness of the enactment unless its arbitrary, unreasonable or oppressive nature is patent." 16 CJS 458.

To decide whether this is a proper classification we should first look to the Michigan Constitution of 1908, Article X, Section 4. This is very pertinent here and cited in almost every Michigan case on proper classification for taxation purposes. It reads as follows:

> "The Legislature may, by law, impose specific taxes, which shall be uniform upon the classes upon which they operate."

It is abundantly clear that the Legislature has the right to create classes. Our Court in Union Steam Pump Co. vs. State, 216 Mich 261 said at page 275 "That the Legislature has the power to classify has also long been recognized. That it is the abuse of such power, not its exercise, that is within the constitutional inhibition, numerous decisions demonstrate."

The governing rules as to classification are stated by Cooley on Taxation, Vol. 1, 4th Edition, Sec. 334 pg. 712 as follows:

> "Conceding that the power to classify exists, the next question is what classifications are proper. The rules are easy to state but their application to particular facts is often attended with difficulty. The following are the governing rules:
>
> 1. A particular classification is proper where based on a reason and not purely arbitrary. There must be a reason for the classification as distinguished from

mere accident, whim, caprice or vindictiveness. 'Clear and hostile discriminations' cannot be made under the guise of classification. A discrimination is not arbitrary, of course, where based on sound reasons of public policy. On the other hand, while there must be a reason for the classification, the reason need not be a good one, and it is immaterial that the statute is unjust. The test is not wisdom but good faith in the classification.

2. Radical differences are not required to sustain a classification for taxation. The differences upon which the classification is based need not be great nor conspicuous. Classification need not depend upon scientific or marked differences in the subjects classified but it is sufficient if it is practical.

3. The reasonableness of the classification cannot be determined by any fixed rule.

4. The Legislature has a broad discretion in the matter of classification. In taxation 'there is a broader power of classification than in some other exercises of legislation'.

5. Classification for taxation is not reviewable by the courts unless palpably arbitrary. It is no concern of the Court whether the classification is the wisest or the best that could be made. The classification need not be 'reasonable and proper' according to the judgment of reviewing judges, but the Court must be able to see that legislators could regard it as reasonable and proper without doing violence to common sense. In other words, 'there must be enough reason for it to support an argument, even if the reason is unsound.' However, a discriminatory tax cannot be sustained if the classification is wholly illusory.

6. When a classification is attacked, and any state of facts reasonably can be conceived that would sustain it, the existence of that state of facts at the time the law was enacted must be assumed.

7. A classification having some reasonable basis is not invalid merely because it is not made with mathematical nicety nor because in practice it results in some inequality.

8. A classification is not invalid because it affects one person or corporation alone where it is broad enough to apply to others if they exist.

It appears to the Court that in many of the Michigan cases dealing with classifications for taxation purposes the above rules have been adopted and are followed: See Jasnowski vs. Board of Assessors, 191 Mich 287; C. F. Smith vs. Fitzgerald, 270 Mich 659; Shivel vs. Kent County Treasurer, 295 Mich 10; Miller vs. State Apple Commission, 296 Mich 248; Banner Laundry Company vs. State Board of Tax Administration, 297 Mich 419; Fitzpatrick vs. Liquor Control Commission, 316 Mich 83; L.S. Coach Lines vs. Secretary of State, 327 Mich 146; U.S. Cold Storage vs. Detroit Assessors, 349 Mich 81; Butterfield Theaters vs. Department of Revenue, 353 Mich 345; McCullagh vs. Department of Revenue, 354 Mich 413; Rockwell Co. vs. Romulus Township, 365 Mich 632.

It is impossible for this Court to reasonably conceive of any facts in this case to sustain this classification so that road contractors doing business with the State should pay the tax and road contractors doing business with, for example, a county should not pay the tax. Such legislation, is, in our opinion patently unreasonable, palpably arbitrary, discriminatory and wholly illusory. What the Legislature in effect has done is to arbitrarily split or divide a natural class without reason therefore and then treat the two differently.

In the case of State Ex Rel Transport Mfg. Co. vs. Bates, 359 Mo. 1002, 224 S. W. (2d) 996. The Court there in dealing with the Use Tax Statute said at page 1008:

"Relator next contends the tax levied is not 'uniform upon the same class of subjects' as required by Sec-

tion 3 of Article X of the Constitution because purchasers of 'motor vehicles having a seating capacity of ten passengers or more' by the Act are exempt from payment of the tax. Subsection (d) of Section 11412.

With wide discretion the General Assembly may make classifications for taxation purposes, but it is uniformly held that persons or property to be taxed may not be classified 'without reason or necessity'. There is no precise yardstick as to reasonableness of classification and the rule of equality of necessity often tends to practical inequalities. Taxation is not an exact science and tax acts are not to be condemned merely because unavoidable inequalities may result. But the classification cannot be 'palpably arbitrary'. And while the General Assembly may enact statutes applicable to and classifying certain persons or property for taxation purposes yet such classification must include all persons or objects naturally falling within the class. Constitutional class taxation must include within the established class all who belong in it and must exclude all who do not belong in it. All in each natural class must be taxed or exempted alike. A natural class may not be split. The Legislature may not arbitrarily designate for taxation a portion only of a separate class and thus exclude a portion which reasonably should be included and taxed. The tax imposed must apply alike to all naturally and reasonably within the classification set up by the statute. 'The demands of the organic laws are satisfied if all similarly situated are included and none are omitted whose relationship to the subject matter cannot by reason be distinguished from that of those included".

Also our Court in the case of Haynes vs. Lapeer Circuit Judge, 201 Mich 138, quoted with approval the following:

"The Legislature cannot take what might be termed a natural class of persons, split the same in two and then arbitrarily designate the dissevered factions of

the original unit as two classes, and thereupon enact different rules for the government of each."

While that case concerns the police power of the State and not classification for taxation purposes, nevertheless the rule there announced appears to be applicable in the instant case, as well. It is manifest upon the face of the statute that the effect thereof is to impose specific taxes which are not uniform upon the class upon which it operates and is unconstitutional as being contrary to Article X, Section 4 of our Constitution of 1908.

The Motion to Dismiss is denied and an Order may so enter.

(s) Marvin J. Salmon
Circuit Judge

Dated: December 3, 1962.

IN THE SUPREME COURT OF THE STATE OF MICHIGAN

L. A. DAVIDSON,
Plaintiff-Appellant,

v. No. 51886

MICHIGAN DEPARTMENT OF REVENUE, now known as the DIVISION OF REVENUE OF THE DEPARTMENT OF THE TREASURY, STATE OF MICHIGAN,
Defendant.

ORDER

AT A SESSION OF THE SUPREME COURT OF THE STATE OF MICHIGAN, Held at the Supreme Court Room, in the Capitol, in the City of Lansing, on the 18th day of December in the year of our Lord one thousand nine hundred and sixty-seven.

Present the Honorable

John R. Dethmers,
Chief Justice,
Harry F. Kelly,
Eugene F. Black,
Thomas M. Kavanagh,
Theodore Souris,
Michael D. O'Hara,
Paul L. Adams,
Thomas E. Brennan,
Associate Justices.

On order of the Court, the application for leave to appeal is considered, and the same is hereby DENIED, as plaintiff and appellant has failed to persuade the Court that he has a meritorious basis for appeal or that the order of the Court of Appeals was clearly erroneous.

STATE OF MICHIGAN—ss.

I, Donald F. Winters, Clerk of the Supreme Court of the State of Michigan, do hereby certify that the foregoing is a true and correct copy of an order entered in said court in said cause; that I have compared the same with the original, and that it is a true transcript therefrom, and the whole of said original order.

IN TESTIMONY WHEREOF, I have hereunto set my hand and affixed the seal of said Supreme Court at Lansing this 18th day of December in the year of our Lord one thousand nine hundred and sixty-seven.

(s) Donald F. Winters
Clerk

APPENDIX B — RELATED OPINION

WALTER TOEBE & COMPANY,
Plaintiff,
v.
DEPARTMENT OF REVENUE,
Defendant.

Civil Action No. 51,430

Civil Action No. 51,431

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1. Taxation — Differences Between State and Its Subdivisions — Exemptions.

Many basic differences exist between the State and its subdivisions that would justify the legislature's exempting the tax on materials used in constructing county, city, or village roads, while not exempting material used in construction of State roads.

2. Same — Classification — Courts — Public Policy.

It is not the function of a court to consider the propriety or justice of a tax, to seek for the motives or to criticize the public policy which sustains the classification adopted, if there are substantial differences between the separate classifications.

References for Points in Headnotes

[1] 51 Am Jur, Taxation §§ 495, 500, 501, 504, 546, 557, 560-564.
[2] 51 Am Jur, Taxation § 340.
[3] 51 Am Jur, Taxation §§ 408-410.
47 Am Jur, Sales and Use Taxes §§ 54, 55.
[4] 47 Am Jur, Sales and Use Taxes §§ 53, 56.
51 Am Jur, Taxation §§ 557-564.
[5] 47 Am Jur, Sales and Use Taxes §§ 53, 56.
51 Am Jur, Taxation §§ 223, 224, 236, 238.
[6] 51 Am Jur, Taxation § 173.
16 Am Jur 2d, Constitutional Law §§ 494-497.
[7] 47 Am Jur, Sales and Use Taxes §§ 43, 53, 56.
50 Am Jur, Statutes §§ 217, 223.
16 Am Jur 2d, Constitutional Law §§ 181-185.
[8] 5 Am Jur 2d, Appeal and Error § 1009.

3. Same — Road Construction Contractors — State — Economic Burden.

A construction contractor with the State does not bear the economic burden of the use tax on materials used in construction of State roads, for although the contractor initially pays the tax, the State reimburses the contractor as he is paid for the work, and the tax is an element of the unit price in the bid.

4. States — Taxation — Immunity — Arbitrariness.

A State in determining problems of intergovernmental tax immunities is dealing with its proper domestic concerns; its power to classify is extremely broad, and its discretion is limited only by constitutional rights and by the doctrine that a classification may not be palpably arbitrary.

5. Same — Taxation of United States Property — Fair Treatment.

State taxation of those making private use of property of the United States government is subject to treatment as fair as that accorded those with whom the State deals itself.

6. Statutes — Classification — Burden of Proof — Arbitrariness.

It is assumed that there was a sound basis in the reason for the legislature's classification in a statute, until the contrary is shown, the party assailing the classification having the burden of showing that it does not rest upon any reasonable basis, but is essentially arbitrary.

7. Appeal and Error — Statutes — Severability — Taxation.

Plaintiffs' contention that the provisions of use tax act selectively removing the tax exemption formerly given to contractors with the United States and the State of Michigan are not severable, and that, therefore, when the amendment respecting contractors with the United States was held to be unconstitutional in a recent decision, the amendment respecting contractors with the State of Michigan also failed *held,* without merit, there being no manifest intent of the legislature that the exceptions set forth be inseparable (CL 1948, § 8.5; CLS 1961, § 205.94; *Knapp-Stiles, Inc., v. Department of Revenue,* 270 Mich 629).

8. Costs — Public Question — Exemption from Use Tax — States — Counties — Municipal Corporations.

No costs are allowed in action for declaratory judgment that provision of use tax act exempting property used in construction of State roads but not property used in construction of roads for counties, cities, or villages (CLS 1961, § 205.94).

Appeal by leave granted prior to decision of Court of Appeals from Oakland; Beer (William John), J. Submitted November 10, 1966. (Calendar No. 13, Docket Nos. 51,430, 51,431.) Decided March 7, 1967.

Complaint by Walter Toebe & Company, a Michigan corporation, against the Michigan Department of Revenue for a declaratory judgment to test the validity of CLS 1961, § 205.94, which imposed use taxes on certain construction materials. Similar complaint by Toebe-Hull Company, a copartnership composed of Walter Toebe & Company and C. A. Hull Co., a Michigan corporation, against the Department of Revenue. Judgments for plaintiffs, holding the section void. Causes consolidated for appeal. Defendant appeals. Reversed.

George J. Fulkerson (*Dennis E. Moffett*, of counsel), for plaintiffs.

Frank J. Kelley, Attorney General, *Robert A. Derengoski*, Solicitor General, *T. Carl Holbrook*, *William D. Dexter* and *Maurice Barbour*, Assistant Attorneys General, for defendant.

Amici Curiae:

Carl H. Reynolds and *Beaumont, Smith & Harris* (*Laurence A. Masselink*).

KELLY, J. These two cases consolidated for appeal, are for declaratory judgments concerning the constitutionality of section 4, subdivision (m) of PA 1959, No. 272,[1] under which there were assessed use taxes against plaintiffs, Walter Toebe & Company and Toebe-Hull Company.

The stipulation of facts pertaining to Walter Toebe & Company states that:

"While engaged as a road contractor in fulfillment of contracts with the Michigan State highway department during the calendar years 1961, 1962 and 1963, Walter Toebe paid certain use taxes through suppliers and also was assessed certain use taxes on purchases of personal property either used or consumed in said construction."

The above quoted stipulation is also made regarding the other plaintiff, except that Toebe-Hull also fulfilled a contract with the county of Wayne during the stated period.

The Oakland circuit judge held that section 4, subdivision (m) imposing a tax on contractors dealing with the State and exempting those dealing with local units of government, constituted discrimination contra to the constitutional provision that: "The legislature may by law im-

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[1] CLS 1961, § 205.94 (Stat Ann 1960 Rev § 7.555(4)).

pose specific taxes, which shall be uniform upon the classes upon which they operate." Article 10, § 4, Constitution of 1908 [Article 9, § 3, Constitution of 1963].

The use tax act was first enacted in 1937[2] and, as originally enacted, it set forth several categories of exemption, including the United States, the State and subdivisions, churches and schools (subdivisions (i) and (j) of section 4).

Section 4, subdivision (i) read:

"The tax hereby levied shall not apply to: * * *

"Property sold to the United States, the State of Michigan, its departments or institutions, or any of its subdivisions."

PA 1949, No. 273, § 4, subdivision (m), extended the exemption by providing that the tax should not apply to "property purchased by persons engaged in the business of constructing, altering, repairing, or improving real estate for others when property so purchased by such persons shall be affixed and made a structural part of real estate in the fulfillment of a contract" with the United States, the State of Michigan, its departments or institutions, or any of its subdivisions.

PA 1959, No. 263, amended section 4, subdivision (m), eliminating the exemption on property purchased by contractors to fulfill construction contracts with the United States, and later that year the legislature by PA 1959, No. 272 (the amendment now under consideration), eliminated the exemption on property purchased by a contractor whether the work was done for the United States or the State of Michigan.

In 1964, by Act No. 164,[3] the legislature restored the exemption on property purchased by contractors in fulfilling their construction contracts with both the United States and the State of Michigan.

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[2] PA 1937, No 94 (CL 1948, § 205.91 *et seq.* [Stat Ann § 7.555(1) *et seq.*]).

[3] Amending CL 1948, § 205.94 (Stat Ann 1965 Cum Supp § 7.555 (4)).

Contending that contractors are a separate class that was split by section 4, subdivision (m) into two parts plaintiffs state:

"The use tax act did establish contractors as a separate class. However, section 4, subdivision (m) arbitrarily split that class into two parts thereby destroying the tax uniformity required so that the use tax was imposed on purchases of tangible personal property by contractors when they fulfilled their construction contracts with the State of Michigan but exempted contractors from the use tax on such purchases involving contracts with cities, villages, townships and counties of the State."

Appellant, contending that section 4, subdivision (m) meets constitutional requirements and that the Michigan legislature had the right to tax tangible personal property used in the construction of State highways and exempting tangible personal property used in constructing roads for counties, cities, and villages, states:

"The history of the exemptions from use tax as pertains to the construction industry uneqivocally demonstrates that the exemption or lack of exemption with which we are here concerned, is one accorded to or denied a State of local governmental entity. The legislature has never sought, in either the sales or use tax statutes, to exempt, or to economically benefit by any exemption, persons such as the appellees who are private construction contractors engaged in activity for profit. To speak of commercial construction contractors as a class and to seek to identify the legislative power of exemption with these private enterprises completely misses the intent of the legislature in granting the exemption or lack of exemption complained of here. Furthermore, a construction contractor with the State does not bear the economic burden of the use tax. It is an element of the unit price in the bid. This raises a serious question of whether appellees have a justiciable issue to raise in these causes. The tax consequence of

the lack of exemption here complained of is one borne by the sovereign State at the election of the legislature. * * *

"The subdivisions of the State of Michigan are on an entirely different legal, political and economic footing than the State of Michigan and its institutions. There exist many basic differences, in fact, which justify the exemption by the legislature of the purchase of material used by plaintiffs in constructing roads and streets for counties, cities, and townships, while taxing the purchase to tangible personal property used by them in constructing highways for the State of Michigan."

We have approved in *Rockwell Spring & Axle Company v. Rumulus Township* (1962), 365 Mich 632, the right to exempt a tax on one division of government and not on another. The plaintiff in *Rockwell* argued that by those leasing the facilities of Willow Run Airport, which were owned by a State supported educational institution, paying no tax, and by the plaintiff paying a tax on substantially identical facilities leased from the county of Wayne, the act was unconstitutional as lacking tax uniformity. This argument was unanimously rejected.

We agree with appellant that there exist many basic differences between the State and its subdivisions that would justify the legislature exempting the tax on materials used in constructing county, city, and village roads and not State roads, and we have stated in cases like the present that it is not the function of this Court to consider the propriety or justness of the tax, nor to criticize the public policy which led to adoption of the legislation. See *W. S. Butterfield Theatres, Inc., v. Department of Revenue* (1958), 353 Mich 345.

The question presented is whether one group of contractors is favored over another group and is not whether the counties, cities, and villages are favored over the State.

Section 4, subdivision (m) did not designate one group of contractors that could bid on State construction work and another group for county, city, and village work. The

stipulation of facts establishes that plaintiff Toebe-Hull fulfilled a contract with the State of Michigan and with the county of Wayne during the stated period.

The contractor engaged in construction activities for the State initially pays the use tax on the materials needed for such construction work, but the State reimburses the contractor as he is paid for the work, and we agree with defendant's claim that "a construction contractor with the State does not bear the economic burden of the use tax. It is an element of the unit price in the bid."

Plaintiff Toebe-Hull Company admits in the pleadings in this case that it considered the tax in computing its bid and thereby such tax was included in its contract price, but claims that this fact is neither "material or relevant to this case."[4]

Section 4, subdivision (m) did not "split that class [contractors] into two parts," as appellees contend. It only split the property purchased in two parts — the property purchased for State construction and the property purchased for completing work for subdivisions of the State of Michigan.

Plaintiffs in this present appeal and Amici Curiae claim that:

(1) *Knapp-Stiles, Inc., v. Department of Revenue* (1963), 370 Mich 629, is controlling;

(2) "The provisions of section 4, subdivision (m) as amended by PA 1959, No. 272, selectively removing the tax exemption formerly given to contractors with the United States and the State of Michigan are not severable. Consequently, when the amendment respecting contractors with the United States was held to be unconstitutional in *Knapp-Stiles, Inc.*, the amendment respecting contractors with the State of Michigan also failed."

Knapp-Stiles, Inc., v. Department of Revenue, supra, is not controlling, as the only question there decided was

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[4] Defendant's affirmative defense, paragraph 3, page 8a of appendix; plaintiff's reply to defendant's affirmative defense, paragraph 3, page 12a of appendix.

the State's right to impose a tax on property used by contractors in fulfilling contracts with the United States while exempting like contracts with subdivisions of the State.

The distinction between the question presented in that case and the instant case has been established in several United States Supreme Court decisions and in *Knapp-Stiles* we cited *Phillips Chemical Co. v. Dumas Independent School District* (1960), 361 US 376 (80 S Ct 474, 4 L ed 2d 384), where it was said (p 385):

"We have made it clear, in the equal protection cases, that our decisions in that field are not necessarily controlling where problems of intergovernmental tax immunity are involved. In *Allied Stores of Ohio, Inc., v. Bowers,* 358 US 522, (79 S Ct 437, 3 L ed 2d 480), for example, we noted that the State was 'dealing with [its] proper domestic concerns, and not trenching upon the prerogatives of the National government.' 358 US at 526. When such is the case, the State's power to classify is, indeed, extremely broad, and its discretion is limited only by constitutional rights and by the doctrine that a classification may not be palpably arbitrary. *Id.,* at 526-528. But where taxation of the private use of the Government's property is concerned, the Government's interests must be weighed in the balance. Accordingly, it does not seem too much to require that the State treat those who deal with the Government as well as it treats those with whom it deals itself."

PA 1945, No. 119 (CL 1948, § 8.5 [State Ann 1961 Rev § 2.216]), sets forth the rule of construction in Michigan concerning "severability," as follows:

"In the construction of the statutes of this State the following rules shall be observed, unless such construction would be inconsistent with the manifest intent of the legislature, that is to say:

"If any portion of an act or the application thereof to any person or circumstances shall be found to be invalid

by a court, such invalidity shall not affect the remaining portions or applications of the act which can be given effect without the invalid portion or application, provided such remaining portions are not determined by the court to be inoperable, and to this end acts are declared to be severable."

There being no "manifest intent of the legislature" that the exceptions set forth in section 4, subdivision (m) be inseparable, plus the fact that the invalidation of one exception by *Knapp-Stiles* in no way affects the operability of the others, we must reject plaintiffs' claim in re "severability."

Applying established principles to determine issues such as here presented, this Court assumes "there was a sound basis in the reason for the legislature's classification until the contrary is shown, and one who assails such classification must carry the burden of showing that it does not rest upon any reasonable basis, but is essentially arbitrary."[5]

We conclude that plaintiffs have failed to meet this test and that there is no basis for the legal contentions advanced by plaintiffs-appellees and adopted by the lower court.

Therefore, the judgment of the lower court is reversed and section 4, subdivision (m), of the Michigan use tax act (PA 1937, No. 94, as amended by PA 1959, No. 272) was constitutional, as it related to contracts with the State of Michigan.

No costs, a public question being involved.

DETHMERS, C.J., and BLACK, SOURIS, O'HARA, and ADAMS, JJ., concurred with KELLY, J.

T. M. KAVANAGH, J., concurred in the result.

BRENNAN, J., took no part in the decision of this case.

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[5] *City of Lansing* v. *Township of Lansing* (1959), 356 Mich 641, 650, 651.

APPENDIX C — CONSTITUTIONAL PROVISION AND STATUTE INVOLVED

Constitutional Provision Involved

United States Constitution, Amendment XIV, Section 1.

Section 1. All persons born or naturalized in the United States, and subject to the jurisdiction thereof, are citizens of the United States and of the State wherein they reside. No State shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any State deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws.

Statute Involved

Mich. Comp. Laws '48, § 205.94(m); Mich. Stat. Ann. § 7.555(4) (m).

Sec. 4. The tax hereby levied shall not apply to:

* * *

(m) Property purchased by persons engaged in the business of constructing, altering, repairing or improving real estate for others when property so purchased by such persons shall be affixed and made a structural part of real estate or used and completely consumed in the fulfillment of a single contract within the exempt classifications set forth in subsections (b), (i), (j) and (k) of this section *other than the United States, its unincorporated agencies and instrumentalities, or any incorporated agency or instrumentality of the United States wholly owned by the United States or by a corporation wholly owned by the United States* [or the state of Michigan, its departments or institutions]; or which shall not be affixed and made a structural part of real estate but shall be transferred to a person in fulfillment of a contract with such person for his use for an exempt purpose as set forth in subsection (f) or (g) of this section.

(Words italicized added by Public Acts of 1959, No. 263; words in brackets added by Public Acts of 1959, No. 272.)